The Functions of a Bank

This is Number One of a series of special articles published by The National City Bank of New York, coincident with the opening of its uptown branches. Number Two will shortly appear in this paper.

A BANK is a common institution, but there are a good many people of wide general information who have only a limited knowledge of the various services of a Bank. A considerable proportion of the population make no direct use of banks and it is easy for these persons to conclude that banks do nothing for them. And there are people who have bank accounts and are accustomed to use bank credit, but who find themselves at times restricted in accommodations, and do not understand why this is necessary. "Am I not good?" and "Is there not as much money in the country as ever?" they sometimes ask. If the supply of available funds is reduced, and the banker adjusts his operations to the means at his disposal, people sometimes think that his action is arbitrary, ill-advised, and perhaps taken with insufficient regard for the general well-being.

Always there has been feeling in some quarters that banking was rather an exclusive and privileged business, remote from the people, but exercising a mysterious and irresponsible power. It has been said that the privilege of using bank credit is dispensed without regard to the best interests of the public, objectionable purposes being frequently favored, while persons who would use it productively are denied accommodations.

It would contribute to good feeling and be generally helpful, if whatever there is of mystery about the banking business might be dispelled, and everybody could have a full knowledge of banking principles and of the relations of banking service to all the activities of the community.

It is a mistake to think that because a person does not have a bank account, or enjoy the privilege of borrowing at a bank, he derives no benefit from the banking system. A man might as well say that he never traveled or shipped any goods, and therefore derived no benefit from railroads. The banking system is an essential part of the modern industrial organization and the highly organized system of trade by which products and services are exchanged. It provides facilities for industry and trade which effect great economies in production and exchange and cheapen the cost of the necessaries and comforts of life to all consumers.

The Development of Money

THE first great step in promoting the division of labor and exchange of products and services, was the adoption of a common standard of value and medium of exchange; in other words, the development of Money. The difficulties of simple barter were so great as to obviously restrict the exchanges. A common standard of value provided a common basis for trade, a means by which commodities could be compared, priced and quoted in different markets, and the universal esteem in which the precious metals were held enabled them to be used as means of effecting exchanges and as standards of value. The gold and silver coins of Athens, Corinth, Syracuse, Carthage and Rome were a common means of making purchases around the Mediterranean and throughout the trading world before the beginning of the Christian Era.

The actual shipment of coin, however, for each transaction, would involve much risk and expense, and where trade ran both ways there was an obvious gain by offsetting the transactions, which soon developed the use of bills of exchange. If a dealer in Rome was shipping certain goods to Athens and at the same time receiving certain goods from Athens, he could easily discharge his own obligation by giving his creditor an order on his debtor; and if there were numerous houses in the trade it would be only another step for them to buy and sell bills as suited their convenience, and one step more to the development of the bill-broker or banker who bought and sold bills on all markets. When Cicero was about to send his son to school in Athens he wrote to inquire "whether he can take a bill for the money he will want in Athens, or whether he must take the money itself with him." This indicates that the settlements between distant cities were handled then substantially as now, by a system of book entries and offsets.

A Banker is a bookkeeper and settling agent for his community in its transactions with the outside world. The products which are shipped out create credits or deposits, in distant banks in favor of local banks, and the purchases outside are settled by drawing against these credits. Since all business in the last analysis consists of an exchange of products and services, it follows that when the checks and drafts arising from current transactions are brought together in the clearing houses they practically offset and cancel each other. A big Chicago meat-packing concern with a turnover of more than a billion dollars per annum, selling meats and by-products in all parts of the world, will draw drafts against its shipments as they are made, turn them over to its bankers and receive immediate credit at their discounted value, thus replenishing its funds for the purchase of more live-stock, etc. The task of collection is a banking function, particularly suited to the employment of the class of funds which a commercial bank has in its custody. As the collections come in, the bank is reimbursed for its advances; the process is continuous and unending.

Trade Settlements Made in New York

THE settlement in the foreign trade of the United States centers largely in New York, and this is the chief clearing center for domestic trade. This is one reason why banks throughout the interior accumulate balances here. The movement of products creates bank credits, or deposits, in the centers. Thus flour from Minnesota, fruit from California, or cotton from Texas, sold abroad, is likely to create a deposit in a New York bank to the credit of a local bank where the shipment originated, the local bank giving credit on its books to the shipper. These New York deposits sometimes involve the interior banks in criticism, from persons who do not understand how the deposits are created. They ask why the local banks should be sending funds to New York. The answer is that for the most part the deposits represent collections for what they have sold, and are in constant motion. The checks charged to the deposit accounts of The National City Bank of New York last year aggregated more than fifty times the average deposits, which indicates that the average life of a deposit, or stay on its books, was about one week. When allowance is made for many comparatively inactive accounts, it will be seen how very active the others must have been. As a rule, each deposit means the collection of a paper item of some kind, which involves further bookkeeping and represents service.

In backward countries banks are but little used by the masses of the people, and money is hoarded, becoming a dead asset. A bank becomes a pool, into which are drained thousands of small sums, easily wasted, or, if not wasted, unproductive by themselves, and the sums so accumulated become active agencies in the life of the community. Untold millions of gold and silver have flowed into India and disappeared. If the owners would deposit them in banks or invest in industrial or railway securities, the effect would be to radically change industrial and living conditions in that country. The increased demand for labor would raise wages, the newly provided industrial equipment would increase production, the higher earnings of the people would absorb the production, and the general standard of living would be raised.

Wage-earners who contribute to the capital fund in modern countries have the satisfaction not only of receiving, as capitalists, the returns on their investments, but of knowing that they are also increasing the demand for labor.

The Servant of Business

DEPOSITS in commercial and savings banks differ in character. The latter are made largely in money, are more or less permanent, are granted an interest allowance, and do not involve any understanding as to borrowing accommodations. Commercial deposits on the other hand consist of the current receipts and working capital of business houses and are made largely in the form of checks, drafts or discounted paper arising daily from the business. The Bank undertakes to count these items into cash, and the account is based upon an understanding that it will render these services and extend a line of credit based upon the net worth and average balance of the customer.

Under this arrangement the relations between the bank and its customers are reciprocal. In each line of trade and industry, it is commonly the case that the use for capital or credit is more or less fluctuating, so that at times each bank customer will accumulate cash balances while at other times needing to borrow. If the business of a bank is well distributed in various lines, and particularly if it is a large bank, doing business in different parts of the country and in other countries, these fluctuations in individual balances and needs will tend to offset and compensate each other, thus securing the greatest economy and best results in the use of the combined capital.

This and the need for large capital to handle the heavy volume of modern business, have been the chief motives in the tendency to consolidation among banking institutions in the principal trading countries in recent years, particularly in London.

As a general rule, the banking business is conducted upon the principle that the depositors of a bank have a first claim upon it as borrowers, and it is safe to say that no bank can hold its own in competition unless it is able to satisfy its patrons that it is conducting its business upon this basis. It amounts to a pooling of certain liquid, shifting resources which must be available for all the members of the pool as they want them, and in fair proportion to their contributions.

It is a mistake, therefore, to suppose that bank funds may be loaned arbitrarily or to serve personal interests or favorites, at the will of bank managers. The rules of good banking may be violated; we do not say they are never violated; but the principles upon which sound and successful banking is conducted are in harmony with the interests of the business community and the general public.

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